Recent advancements in securities litigation in Italy

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INTRODUCTION

Financial litigation has probably been the most significant phenomenon in the Italian civil litigation landscape during the last 15 years. There has been an extraordinary increase in the number of cases concerning breaches of conflict of interest and conduct of business rules by banks and investment companies in the sale or brokerage of financial instruments. Initially, these cases concerned retail investors. After the 2007-2008 financial crisis, however, derivatives litigation increased exponentially, with banks being accused by small and medium-sized firms, as well as by local public entities, of having sold unsuitable interest and currency swaps. All these cases regarding misselling of financial products attracted a great deal of attention from the Italian legal community, to the point that, in many Italian circles, misselling litigation is regarded as the main kind of financial litigation.

With little fanfare, but in cases involving a much larger amount of money, securities litigation has been increasing as well. The Parmalat scandal was probably the turning point. There are now Italian court decisions that cover almost all of the most significant areas of securities law, and Italy is therefore a European jurisdiction where private enforcement of securities regulation has become substantial.

In particular, courts have established a noteworthy and coherent row of decisions concerning misstatements to the market. This is an area of securities regulation where the nature and extension of private rights can now be considered well settled. In particular, an important case of insider dealing liability, SCI (Cassation Court, 3 July 2014, no. 15224), has recently reached the Cassation Court and is reproduced with the permission of the publisher, Thomson Reuters. This article was first published in the Capital Markets Global Guide 2015/16 © Thomson Reuters 2015

An overview of the formal obstacles faced by claimants in securities litigation.

LIABILITY FOR MISSTATEMENTS TO THE MARKET

This section provides an overview of the law relating to liability for misstatements to the market, including the basis of liability, relevant statutory rules, the burden of proof, persons that can be held liable, and other relevant features.

Basis of liability for corporate misstatements

Liability for corporate misstatements is traditionally considered to be founded in pre-contractual or tort liability. Around 30 years ago a distinction was drawn between the following cases:

- Cases where the misstatement involved parties that were negotiating a transaction. In this case, liability for misstatement was considered under the pre-contractual rules of good faith. A typical example of this kind of case concerned liability of the underwriters for the prospectus.
- Cases where the false or inaccurate information was given to a third party without any involvement from the information provider in the transaction. In this case, liability was considered under the rules of tort. A typical example of this case concerned the liability of directors and auditors towards investors.

Although broadly the difference between pre-contractual and tort liability continues to apply, at the time the difference was perceived to be significant because of potential differences in the burden of proof and the length of the statute of limitation. This is now regarded as being less important, for two reasons:

- According to a decision of the Court of Cassation, pre-contractual liability is now seen as part of tort liability (Cassation Court, 11 June 2010, no. 14056).
- Statutory rules have been introduced to regulate the burden of proof and the limitation period for prospectus liability claims (see below, Statutory rules and Burden of proof).

One matter has not changed, however: the basis for liability for misstatement is a standard of negligence, or, in the case of liability under the rules of tort, a distinction was drawn between the following cases:

- An overview of the formal obstacles faced by claimants in securities litigation.
- An overview of case law concerning liability for misstatements and the approach the courts have taken to issues of causation.
- An analysis of the decision in SCI.
- An analysis of the decision in Sai-Fondiaria.
contained in the prospectus is liable for the information provided towards any reasonable investor who relied on this information, unless it can be proved that sufficient due diligence was performed to ascertain that the information was true and there were no significant omissions (Article 94(8), CSFA). The lead manager is also liable unless due diligence can be demonstrated. The lead manager, according to the law, is the intermediary that organizes and establishes the consortium, the co-ordinator or the single underwriter (Article 93-bis, lett. e, CSFA). This means that liability attaches not to the intermediary that has been mentioned as lead manager in the prospectus, but to any de facto lead manager. The limitation period is five years.

**Directors’ and statutory auditors’ liability.** Liability for misstatements from directors and statutory auditors to shareholders and third parties is regulated by Article 2395 of the Civil Code. Article 15 of Legislative Decree no. 39/2010 provides for liability to auditors towards the company, shareholders and third parties for non-compliance with auditor duties. Article 154-bis of the CSFA concerns liability for managers charged with preparing companies’ financial reports. The limitation period for this branch of liability is always five years.

**Burden of proof**

Previously, the burden of proof in misstatements to the market was the subject of significant discussion, because of the difference between the burden of proof in pre-contractual liability and in tort (see above, Basis for liability for corporate misstatements). In the case of pre-contractual liability the defendant has the burden of proof, whereas in general tort the claimant has in principle the burden.

However, this distinction is no longer seen as being meaningful. Article 94 states the plaintiff can claim damages caused by misstatements in the prospectus, and the defendants have a due diligence defence. Accordingly, the burden of proof is shifted to the defendant in prospectus cases. However, in practice in the majority of court cases the claimant brings its claims both under prospectus liability and general directors'/auditors’ liability, because misstatements can be found in the prospectus, ad hoc information to the market, financial statements, and so on. Therefore, although the burden of proof should in theory be different, it would be very difficult to apply different regimes to a single misstatement repeated in different forms and documents. Therefore, courts are never too formalistic on this point. Finally, Italian courts are now very inclined to use the “vicinity to evidence” doctrine to shift the burden of proof to the defendant in other forms of tort liability. Under that doctrine, the claimant is not asked to offer full evidence of circumstances concerning which he has no way to get information.

This approach to the burden of proof may appear to be liberal to a common law lawyer. However, Italian civil procedure does not offer instruments that can be compared to US discovery or UK disclosure (except in a limited number of cases, which are not relevant to cases of financial misrepresentation). The claimant’s access to information is limited (see below, Obstacles to investors’ claims). Therefore, Italian courts keep some freedom in allocating the burden of persuasion and the burden of proof through the use of rebuttable presumptions. As a consequence, an Italian court can consider certain facts as being sufficient to shift the burden of proof on the defendants which a common law court would never consider as being circumstantial evidence in favour of the claimant.

**Persons that can typically be held liable**

The regime of liability for misstatements to the market is wide ranging. Anyone who participates in the diffusion of statements on behalf of the company or related to the company becomes potentially liable for any materially inaccurate or false information. However, there are a number of legal and natural persons that are typically involved:

- **The company itself.** This is generally the first recourse, however, frequently the company will be insolvent or on the verge of insolvency.
- **Directors.** Directors are personally liable for misstatements (Article 2395, Civil Code) (see above, Statutory rules). They are liable even though they disclosed inaccurate or false information on behalf of the company and to the apparent benefit of the company rather than themselves, and are not shielded by the corporate entity. This would not remove the liability of the company, as directors would have been acting as representatives of the company. A company cannot insert a provision excluding directors’ liability towards shareholders and market investors in the corporate charter, but it is increasingly common practice for companies to arrange D&O insurance in favour of their directors and officers.
- **Auditors.** Auditors are another common target of securities litigation, to the point that Italy has been mentioned as one of the jurisdictions where auditors are most likely to be found liable. Auditors do not benefit from any liability cap and cannot limit their liability towards the company, its shareholders and investors.
- **The lead manager and individuals responsible for Information In a prospectus.** In relation to prospectuses, any person that provides information contained in a prospectus is liable for any misstatement, and the lead manager is liable unless it can establish a due diligence defence (see above, Statutory rules).

**Other features**

As part of the general tort liability regime, the rules concerning misstatement to the market are governed by the principle of joint and several liability. This means that liability can also extend to those who have aided or abetted the misstatements, and liability cannot be limited, as it is not contractual in nature.

No distinction is made between primary and secondary markets. So far as liability for the prospectus is concerned, Article 94’s liability regime mainly addresses primary market liability. It is, however, applicable whenever there is a prospectus, and therefore it is not strictly related to primary market transactions. Moreover, it also applies to the information contained in the listing particulars (Article 113, CSFA).

Finally, there are no special insolvency rules concerning investors’ claims. Accordingly, investors’ claims rank pari passu with unsecured creditors.

**THE CASE LAW**

This section provides an overview of the primary cases concerning securities litigation in Italy. It considers the main cases. Two cases, SCI and Sai-Fondiaria are considered separately because of their importance (see below, Liability on insiders for market trading: SCI and Acting in concert: Sai-Fondiaria).

**Overview of cases: approach of the courts to demonstrate reliance**

**American Service Bank:** American Service Bank (Milan Tribunal, 11 January 1988; Milan Court of Appeal, 2 February 1990) is a case from the late 80s, and it is considered to be the Italian leading case on prospectus liability. An underwriting bank had aggressively promoted an issuer’s corporate bonds to its retail clients, overstating the profitability and chances of success of the issuer, which subsequently became bankrupt. The Milan Tribunal, upheld by the Court of Appeal, applied pre-contractual liability standards and awarded damages in the amount of the lost capital plus interest, considering the alternative investment in Italian state bonds that investors could have made with an equivalent amount of money.
In principle, it is for the paid was highly inflated. In the Italease opinion we find all the investor brought a claim, arguing that the purchase price it had 2008), one of the many cases arising from the Parmalat scandal. shares and bonds on the market in the period interested by the which were used to hide the negative results of the dairy group. The prospectus contained material misstatements concerning the number of the company's clients and a large number of investors (the final number was 1165) who had purchased its shares in the course of the IPO and in the secondary market sued the lead (the final number was 1165) manager and sponsor, the auditor, and the securities watchdog (Consob). This was not a class action but a permissive joinder of claims. The Milan Tribunal held everybody liable toward investors. Italaudit. A few months after the decision in Freedomland, the Milan Tribunal decided Italaudit (Milan Tribunal, 4 November 2008), one of the many cases arising from the Parmalat scandal. The case concerned the auditor of some of Parmalat's subsidiaries, which were used to hide the negative results of the dairy group. The court awarded damages to the investors who had bought Parmalat shares and bonds on the market in the period interested by the inaccurate audit.

Italease. Italease (Milan Tribunal, 22 luglio 2010) concerned a bank that had concealed its trade in derivatives, which had generated huge losses. Similarly to the Fingem case, a professional investor brought a claim, arguing that the purchase price it had paid was highly inflated. In the Italease opinion we find all the issues commonly discussed in this kind of action around the world, first of all reliance. Indeed the defendant argued that the claimant had to consistently prove reliance. The claimant, however, provided evidence of the manner in which the information had been collected, elaborated, and the investment decision had been taken. As a result, the claimant won the case. The damages were measured according to the difference between the purchase price and the sale price after the disclosure of the truth about the company. Issues not yet considered. What is still missing in the now developed Italian jurisprudence in capital markets law is a case of corrective disclosure of a solvent company, followed by a sharp price drop and by investors’ suits. Italease was close to this situation, but in reality the company was already on the edge of insolvency. Italian courts and transaction causation. In principle, it is for the claimant to prove that, in acquiring or disposing of securities, it acted in reliance on the published information, and that this reliance was reasonable. This applies to both liability for the contents of a prospectus and to the traditional tort regime.

In practice, however, the case law demonstrates that it has never been an obstacle for the claimant to prove reliance. The courts have inferred reliance from the facts, by finding that:

- There has been a misstatement or an omission in a situation where the issuer had a duty to disclose.
- Without the misstatement or the omission, the claimant would have purchased or sold at a different value, because the true information would have had an impact on prices.

Evidence that the investor had actually acquired and acted on the wrong information has not been considered an issue, since the courts have consistently presumed that the wrong information reached the investor through financial advisers or other financial intermediaries, or that the market price reflected the lack of right information. Italian courts have avoided any reference to the US fraud-on-the-market (FOTM) theory or any similar concept. Their reasoning is probably more influence by the old German doctrine of "investment atmosphere", which is a precursor to FOTM, and which asserts that misstatements can generate a sort of investment euphoria that is independent from specific reliance on the misrepresented facts.

This approach to transaction causation issues has greatly facilitated the permissive joinder of claims, both in prospectus liability cases (Freedomland) and in other cases (Italaudit). For instance, in Italaudit, investors' reliance on Parmalat group consolidated accounts was not even discussed in the court's opinion. Reliance was taken for granted, because the court reasoned that the inaccurate accounts provided the whole market with inaccurate information regarding the group situation, and the investors had, therefore, purchased financial instruments, while being unaware of the truth. Investors were not required to prove that they had read and relied on the group financial statements. If this is not FOTM, it is very close to it indeed.

**Liability on insiders for market trading: SCI**

The SCI case is of great significance. It is a misstatement case that was treated as an insider trading case by the claimants and the court.

SCI was a small-cap that was negotiating a debt restructuring plan with banks. Following a previous plan containing debt-equity swap provisions, the bank were also shareholders of the company. At a certain point in time, it appeared clear that there was no way to save the company. The company did not disclose this information. The banks gradually sold SCI's shares on the market, where there were many rumours that the company could become a takeover target. Investors who purchased the shares brought claims not against the insolvent company and its directors because of the non-disclosure, but against the trading banks, alleging that:

- Increased market activity had induced them to buy SCI's shares.
- The banks as controlling shareholders should have informed the market about their decision to sell the shares.
- The banks' behaviour was unfair.

The investors won both at first instance and on appeal, even though they did not get full compensation because their requests were reduced in equity.

The banks brought the case to the Cassation Court, which held that insiders have a general “disclose or abstain” duty, based on general principles of civil law and European capital markets law, about transparency, and on the investors' right to operate in a fair and transparent marketplace. The banks did not abstain from trading while in possession of inside information concerning the firm, and the Cassation Court held the banks liable for the damages suffered by the investors. Through this line of reasoning the Court was able to set aside all transaction and loss causation issues that are typical of insider trading liability cases, without considering that under Italian and European law insiders do not have a disclosure duty, which falls on the issuer and its controlling shareholder. It is clear that the Italian Supreme Court made recourse to the US “disclose or abstain” maxim in an effort to enhance private enforcement and elude traditional causation issues, such as those regarding the link between insider negotiations on the market and investors' reliance and losses.

The SCI case is probably the first European case where a European supreme court has endorsed a theory of civil liability for market trading by an insider.

**Acting in concert: Sai-Fondiaria**

Sai-Fondiaria case is Italy's most significant action in concert case. As with SCI, this case is of European significance, as probably the global.practicallaw.com/capitalmarkets-guide
first, big private litigation case concerning evasion of mandatory takeover rules.

An important insurance company took control of a listed competitor through an elaborate scheme aimed at eluding mandatory takeover rules. The scheme was discovered by the Italian competition law agency. Minority shareholders therefore brought an action in damages against the insurance company, even though Italian mandatory bid rules do not contain any specific rule concerning minority shareholders’ entitlement to damages.

The Milan Tribunal decided that minority shareholders have a right to damages, whereas the view of the Court of Appeal was diametrically opposed. The case reached the Cassation Court, which once again decided in favour of investors, further demonstrating that the Italian Supreme Court wants to offer a high level of protection to investors’ private right of actions.

OBSTACLES TO INVESTORS’ CLAIMS

The liberal approach of Italian courts to investors’ claims can partially be explained by reference to the obstacles to investors’ claims.

No class action mechanism

There is no class action mechanism, because the collective redress scheme adopted by Italian law does not cover tort actions. Since liability for misstatements to the market is a case of tort, class actions are not available. Moreover, class actions are available to consumers and retail investors only.

Lack of access to information

Claimants face a significant problem of access to information. Italian civil procedure has nothing comparable to US discovery or UK disclosure. Moreover, the Italian system adopts a fact pleading system, where the claimant must establish with sufficient clarity with the writ of summons and complaints the factual circumstances his claim is built on.

In prospectus liability cases the problem is reduced because of the statutory shift in the burden of proof, and in other cases of misrepresentation the court can be convinced to accept a lower level of evidence support and then to shift onto the defendants the burden of proof (see above, Liability for misstatements to the market). Nevertheless, some well-grounded information is required to both build a case and reply to defendants’ counterarguments. Accordingly, investors usually try to gather the information required to bring a civil action by requesting an investigation by Consob, the Italian securities authority. However, Consob is not always very reactive, because it is involved in other large cases, or because it does not believe or does not understand the preliminary information provided for by the investor. If Consob pursues the case, the investor still has limited access to information, and if at the end of the investigation Consob fines the company, the decision is usually very short and undetailed as to the fact finding, making very difficult for the investor to determine the facts relevant for his action. Civil courts can take Consob’s decisions as prima facie evidence of the facts ascertained by Consob, but when the facts are not clear or when Consob has misunderstood the facts, claimants face big problems in establishing the actual sequence of events that occurred at the defendant’s level, and the absence of any discovery mechanism becomes a serious obstacle.

These problems of access to information are typical, at least in Italy, of any situation where there is an interplay between private law and regulation, such as anti-trust and banking. These cases, therefore, require legal teams working at the edge of the regulatory and private law frontiers.

CONCLUSION

Investors should not underestimate the potential of securities litigation in Italy. There are many barriers to overcome, but the rewards can be substantial, because courts understand the value of private enforcement of regulatory issues.

As to issuers, the standard attitude of Italian listed companies and their directors is to focus entirely on the risk posed by the securities authority’s actions and to underestimate the dangers coming from private litigation. This attitude should be changed and executives must learn to deal with market information with increased care.
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- Assisting the board and the members of the audit committee of a leading shipping group that is negotiating various debt restructuring agreements with its lenders both in Italy and abroad.
- Representing in court together with his partner Francesco Munari a group of 64 institutional investors advised by Deminor in the first Italian case on earning restatements.

Languages. Italian, English.

Publications. He has written two books and has covered capital market contracts in one of the most authoritative Italian treaties on contracts. He has written several articles and chapters on Italian and European top law journals and books.

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Recent transactions
- Assisting and representing in court an Italian company in the largest Italian case of request for damages (private enforcement) for illegal granting of State aids.
- Assisting and representing in courts an Italian wheel-rims maker to obtain the application of the repair clause and of the rules on free movement of goods to replica wheel-rims against alleged infringement of German car manufacturers’ intellectual property rights.
- Representing in court together with his partner Paolo Giudici a group of 64 institutional investors advised by Deminor in the first Italian case on earning restatements.

Languages. Italian, English, German, French.

Publications. He has written three books and several articles and chapters on Italian and European top law journals and books, mainly concerning business regulation, anti-trust and international law.